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C O N F I D E N T I A L SECTION 01 OF 02 SOFIA 000169

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SUBJECT: EU FUNDING FREEZE HIGHLIGHTS NEED FOR REAL REFORM

REF: SOFIA 0017

Classified By: Ambassador John Beyrle for reasons 1.4 (b) and (d).

¶1. (C) Summary: The announcement of the suspension of three EU pre-accession funding mechanisms due to allegations of fraud and mismanagement has the GOB pointing fingers and engaging in damage control. After an initial defensive reaction to the EC's decision, the GOB put in place a 16-step program to improve the management of EU funds. But if Bulgaria is to have the opportunity to tap into the more than seven billion euros in EU funds it stands to receive by 2013, it will have to do much more to relieve Brussels' growing skepticism. The GOB will have a chance to show progress when Commission monitoring teams arrive in April and May in preparation for the release of a comprehensive monitoring report to be released in July. End Summary.

¶2. (U) The European Commission's Directorate General on Agriculture and Rural Development announced the suspension of 40 million euros in SAPARD funding in a March 6 letter to the Bulgarian Finance and Agricultural Ministries. The announcement affects 49 on-going projects funded by SAPARD, the EU's pre-accession instrument promoting agriculture and rural development. The SAPARD monitoring committee said the suspension is linked to an on-going investigation by the European Anti-Fraud Office (OLAF) for misuse of EU money in several European countries. The SAPARD announcement followed a February 29 Commission decision to suspend an estimated 51 million euros in Bulgarian PHARE funds (a pre-accession funding mechanism for economic and market restructuring) going to 14 projects. Explaining this action, the EC said it had found 25 irregularities in the implementation of three public procurement projects funded with EU money.

¶3. (U) The bad news started a month earlier, when, on January 25, the EC announced it had frozen 144 million euros in ISPA funds (pre-accession infrastructure moneys) intended for three Bulgarian road construction projects. With the freeze, the Commission said it sought to prevent further abuse of EU public funds following allegations of conflict of interest by the head of the Bulgarian Road Infrastructure Fund (RIF), Vesselin Georgiev. Days earlier, two RIF officials were arrested holding 50,000 leva (35,000 USD), which was allegedly given by a local businessman in return for Georgiev's signature on a project. Although an investigation by the Finance Ministry reported no abuse of EU funds, Georgiev was forced to step down following the revelation that he had awarded millions of leva in public money to his brother's road construction company.

¶4. (SBU) The GOB reacted defensively to the funding suspension. The Ministries directly implicated in funding misuse -- Finance, Regional Development and Agriculture -- downplayed the EC actions, calling them temporary and promising to have the funds flowing again within months. Some officials laid blame on the Commission itself for lack

of sufficient oversight during the time the EU had a delegation present in Sofia. Other officials threatened to reveal names of public officials and companies, including MPs and individuals close to high-ranking officials, who were allegedly siphoning EU funds. Opposition leaders quickly capitalized on the scandal, noting that the government had ignored EU warnings coming as early as November 2007 that pre-accession funds were in danger. Sofia Mayor and head of the popular center-right party GERB Boyko Borissov pointed out that average Bulgarians were paying the price for the current government's mishandling of EU funds. The opposition, center-right Democrats for a Strong Bulgaria party of ex-PM Ivan Kostov demanded the resignations of the Ministers of Regional Development, Finance, Environment, Agriculture, and Transport. While the call was unsuccessful, the controversy has re-ignited rumors of a cabinet reshuffle.

Public reaction was muted as allegations of corruption and embezzlement have become a mainstay in the press. A poll done just after the news of the funding freeze broke showed that 41 percent of Bulgarians say EU money will go to businesses close to the government, while 34 percent believe the money will not be used properly.

15. (SBU) Overcoming its initial defensive reaction, on March 12 the Government approved a package of 16 corrective measures to improve the management of pre-accession and structural funds. The most important steps include the creation of a public register of beneficiaries of pre-accession and operational funds; the hiring of external auditors; and stricter rules for reporting irregularities by implementing agencies. The Government is also contemplating the relocation of the unit in charge of combating fraud related to EU funds from the Ministry of Interior to the new national agency for security DANS. Finance Minister

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Oresharski and EU Affairs Minister Grancharova were dispatched to Brussels March 14 to calm the row with the Commission. Upon their return, the two hinted that Brussels has evidence of even more incidences of wrongdoing related to EU funding in Bulgaria. They promised Bulgaria would "improve communication" with OLAF. The GOB will try to build Brussels' confidence in Bulgaria's ability to handle EU funds when EC President Barroso visits Sofia March 28.

16. (C) Comment: Bulgaria stands to receive more than seven billion euros in EU structural, cohesion and agricultural funds in the next five years. Due to weak administrative and absorption capacity, as many predicted, in Bulgaria's first year as an EU member, it received little more than it paid in membership dues. In 2008, post-accession money began to trickle in - funds for enhancing administrative capacity began in January and the first direct payments to farmers arrived in February. But if the management of pre-accession funds is a test of Sofia's ability to control the overwhelming influx of funds the country is set to receive as a member state, the country has received a failing grade. Brussels-based EC representatives have told us that Bulgaria's defensive reaction to the suspension of funds -- and to the EC monitoring of Bulgaria as a whole -- is winning no friends in the Commission. With little progress on critical rule of law issues noted in the Commission's February interim monitoring report and the uncovering of pervasive mismanagement of EU pre-accession funds, our contacts tell us a sense of buyer's remorse about Bulgaria is setting in in Brussels. Bulgaria will need to do more than just "improve communication" with the Commission antifraud office to regain Brussels confidence and avoid more painful funding freezes. The GOB will have a chance to redeem itself in April and May when the Commission sends teams to Bulgaria in preparation for a comprehensive monitoring report to be released in July. We will meet with these monitoring teams to ensure we are speaking with one voice on the rule of law issues high on our agenda.

Beyrle